

International Baccalaureate

Diploma Programme

Economics

Standard level paper 1

(For first teaching 2011, first examinations 2013)

P1 SL economics specimen paper exemplar scripts

Script	Question	Marks	Notes
E	1 (a)	6	
	1 (b)	3	
F	1 (a)	8	
	1 (b)	11	
G	3 (a)	4	
	3 (b)	8	
H	3 (a)	8	
	3 (b)	11	

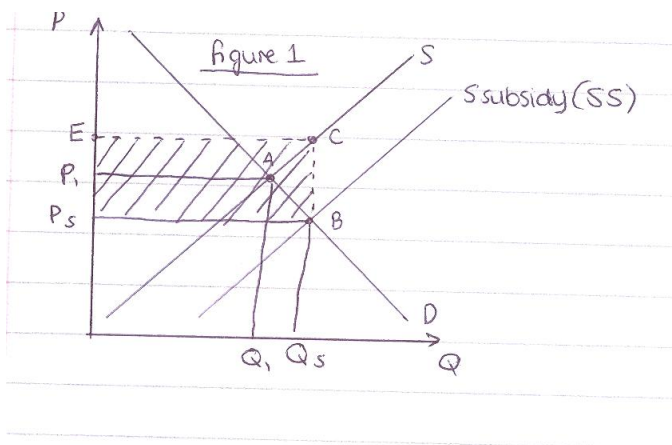
SL P1 SAMPLE E

1. (a) Explain why a government might introduce subsidies for food.

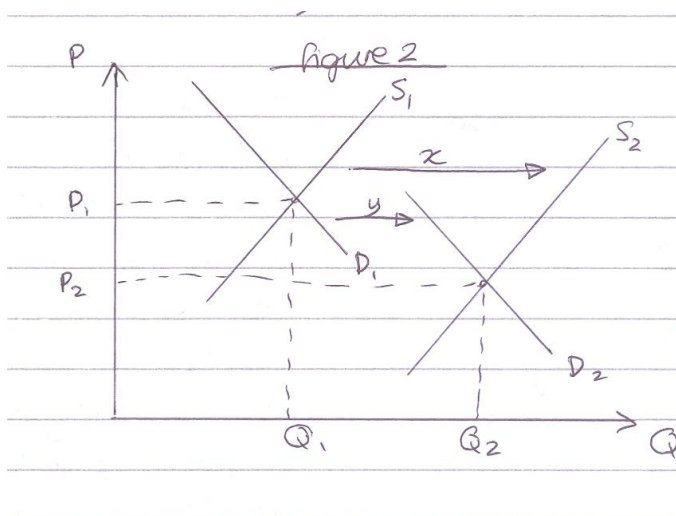
Introducing subsidies (government funding for a good or service allowing for more output) for food is a method of intervention. As shown in figure 1 without subsidies farmers would produce q_1 at p_1 . Introducing subsidies at CB will shift the supply curve from S to $S_{\text{subsidy}}(SS)$ to produce an output higher than q_1 , at q_s , at a price lower than p_1 at p_s . This means that the government will subsidise farmers with shaded region EpsBC, allowing them to produce more and also to earn more. Moreover consumers will pay a lower price of p_s rather than p_1 .

Comment [A1]: Attempts a definition.

Comment [A2]: The diagram is clearly explained.



Thus subsidies will be able to address several issues. First of all, it will ensure food supply such that it will divert a country from famine and food shortages. It will also provide an incentive for farmers. There has been a tendency for the incomes of rural farmers to decrease while urban workers increase. By simply producing more output farmers will not make more as shown by figure 2.



In the long run despite supply increasing by a lot, (as shown by the shift X), the demand for food does not increase by relatively that much (as shown by the small shift in the demand curve from D1 to D2 by Y). Thus farmer incomes are not increasing but rather decreasing. In such an event, subsidies will help revive their incomes as they will make everything below line EC on figure 1.

Comment [A3]: Why has it, what is the reasoning?

Subsidising also is a method of protecting local food producers as food will be cheaper (P_s rather than P_1 on figure 1) for consumer purchase.

Comment [A4]: There is some knowledge of relevant theory and an understanding of the question.

Level 2 6/10 marks.

- (b) Discuss possible negative consequences that may arise from a government decision to subsidize food.

A decision to subsidise food however could consequently cause the production of the food to not be allocatively efficient. This is where the production of the food does not achieve the maximum output by using up all the raw materials. Another problem that might occur is that producers might take advantage of the subsidy by producing for maximum profit rather than at a social optimum. Farmers may over produce food and create surpluses. An example is the EU. Both farmers and consumers gain more from the government subsidies. There is an opportunity cost since this money could have gone to more pressing matters.

Subsidising local food markets, although protects the local market, could potentially be destructive for food exporters. Particularly LEDCs which depend on food exports (such as Thailand and rice) will suffer.

Comment [A5]: Little knowledge of relevant theory. There is limited understanding of the specific demands of the question.

Level 1 3/15 marks.

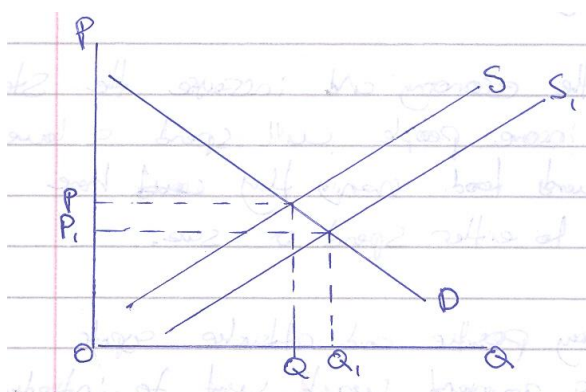
SL P1 SAMPLE F

1. (a) Explain why a government might introduce subsidies for food.

Subsidies are sums of money paid by governments to producers, in this case farmers, to lower the costs of production and to increase the output of the firm. This in turn allows producers to charge lower prices to consumers. This means that subsidies are beneficial for the consumers and the producers, the consumers pay a lower price and the producers gain in revenue. The demand for food as a whole is normally considered to be price inelastic and so the subsidy might have to be large to make much difference to consumption.

Comment [A6]: Definition.

Comment [A7]: Good observation.



Comment [A8]: The diagram is correct although the cost of the subsidy is not shown.

As you can see from the diagram the subsidy shifts the supply curve downwards from S to S_1 , decreasing the price from P to P_1 and therefore increasing quantity demanded of the product from Q to Q_1 . Farmers will receive a price of P_1 per unit plus the subsidy given by the government, which is the vertical distance between the two supply curves.

Comment [A9]: The diagram is clearly explained.

Governments have a number of reasons for wanting to bring in subsidies for food. They might help improve the competitiveness of farmers and enable them to withstand lower priced imports however this creates an artificial advantage. There is also the possibility that subsidies would enable the export of agricultural products and so that would improve the balance of payments on current account. Farming is one of the most protected industries in the world. So subsidies to agriculture are a form of trade protectionism. It's possible that a government might want to protect jobs in farming, in many countries particularly low income countries farming is a big source of employment. Another reason a government might want to subsidise agriculture is to help the poor, people on low incomes.

Because the supply of food depends a lot on the weather the crop can vary a lot between seasons and so the price can fluctuate a lot. This is bad for people on low incomes and can affect the rate of inflation. So subsidies can act like a price control to help stabilise prices. Subsidies can help economic growth and they can raise the standard of living. So there are many reasons why a government might want to introduce subsidies for food.

Comment [A10]: This is a weak point, subsidies do not stabilize prices.

Comment [A11]: The question is, on the whole, clearly answered. Diagram is not complete although text is appropriate.

Level 3 8/10 marks.

- (b) Discuss possible negative consequences that may arise from a government decision to subsidize food.

Although there may be many positive reasons for introducing subsidies for food, as described in part (a), there are also negative consequences. Subsidies can have the effect of making producers relatively inefficient. This is because farmers may not have the incentive to improve efficiency and may come to rely on the subsidies.

Another impact is as was seen in the EU where farm support led to overproduction. With surpluses occurring, this is a waste of resources. If farming is made relatively more efficient by subsidies then that might lead to a reallocation of the factors of production with more going into farming and away from more efficient, but unprotected industry. This would be an efficiency loss for the economy.

Another problem with the use of subsidies is that there is an opportunity cost associated with them. An opportunity cost is the price of something expressed as the next best alternative foregone, meaning that the government revenue could be spent elsewhere on hospitals and schools infrastructure etc. The subsidy will transfer money from tax payers to the producers and consumers of the product.

Many countries use subsidies for food and it has caused lots of arguments at the WTO, where talks are currently stalled on this issue. At present the WTO is trying to agree on a new trade agreement but some countries want rich countries to stop subsidising their farmers because it is unfair. Subsidized food exports from the EU and the USA, for example, have very damaging effects on the production of food in developing countries.

Comment [A12]: In some ways a good answer. It is to the point and answers the question. Examples are used and the student shows economic awareness regarding the WTO and developing countries. There is an attempt to evaluate.

Level 3 11/15 marks.

SL P1 SAMPLE G

3. (a) Distinguish between structural unemployment and cyclical (demand-deficient) unemployment.

Unemployment is when people in the working age group are looking for a job but are unable to find one.

Comment [A13]: Limited attempt at definition.

Structural unemployment is a part of natural unemployment where a demand for a certain good falls and therefore the firm would collapse and the skills of its labour are not needed any more. However, firms would not necessarily require the same skills therefore workers would need to acquire new skills in order to find a job.

Cyclical unemployment is a part of disequilibrium unemployment. Cyclical unemployment follows the business cycle. Workers would become unemployed at the time of a recession because firms are unable to pay for their salaries because they would have to cut costs to maintain their revenue.

Comment [A14]: Some limited understanding of relevant concepts.

In structural unemployment the demand for a good may fall thus firms may collapse. People would also be replaced by technology if their skills are not needed any more. Usually this is because of change in economic structure for example agriculture to industry.

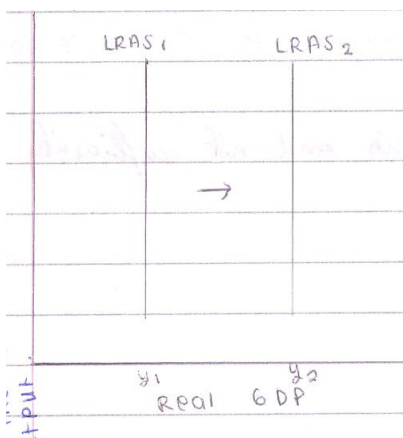
Comment [A15]: Lacks diagrams which could have supported the response. The student has an idea of the types of unemployment specified. There is an attempt to define unemployment. This response is simplistic and lacks development.

Level 2 4/10 marks.

- (b) Discuss policies that a government might use to reduce the levels of structural unemployment and cyclical (demand-deficient) unemployment.

Structural unemployment occurs as a type of the natural rate of unemployment where the economy is producing a level of output equal to the level of output it is capable of producing. Measures to deal with structural unemployment includes shifting the LRAS curve to the right from LRAS1 to LRAS2. These include supply side policies aimed to make real wages more responsive towards changes in supply and demand for labour.

Comment [A16]: What would that do?



Comment [A17]: Poor labelling.

Interventionist measures are measures that the government can implement in order to reduce the level of structural unemployment in an economy. These can include lowering unemployment benefits as an incentive to make unemployed workers more motivated to find a job. Providing training programs for unemployed workers to gain new skills for jobs that are more in demand, lowering minimum wage legislation, subsidies for wages to firms so they are more willing to employ

Comment [A18]: Not an interventionist, but market based policy.

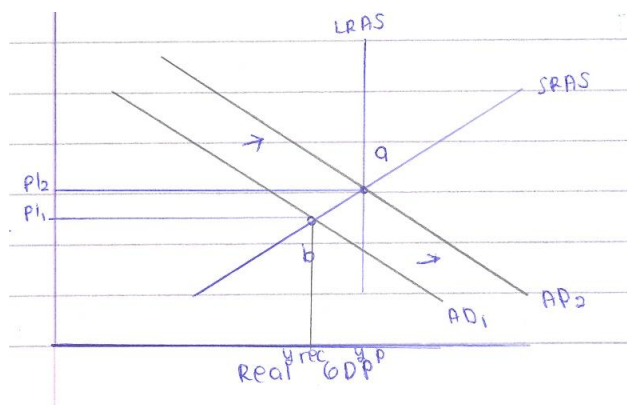
structurally unemployed workers and lowering income taxes to increase the incentives for people to work. The major disadvantage for interventionist measures is that it requires a high level of government expenditure where an opportunity cost is present.

Comment [A19]: Also not an interventionist but market based policy.

Comment [A20]: Some understanding of appropriate policy but also confusion over relevant measures.

Cyclical unemployment occurs when the economy is undergoing a recessionary gap. This is when the economy is producing a level of output that is less than the level of output the economy is capable of producing. This occurs when there is insufficient level of AD in the economy to produce the level of potential output. Measures to deal with cyclical unemployment involve shifting the AD curve from AD₁ to AD₂. Cyclical unemployment at first lies at point b where there is a recessionary gap. Its aim is to shift the AD curve to the right from AD₁ to AD₂ to eliminate the recessionary gap.

Comment [A21]: Some understanding again and the diagram is referred to but a lack of development.



Comment [A22]: Incomplete labelling.

So that the economy will be at full employment, point a. Policies that governments might use to reduce the level of cyclical unemployment includes demand side policies (monetary and fiscal) aimed to increase the aggregate demand level of the economy, this includes lowering minimum wage legislation.

Comment [A23]: Not explained.

Comment [A24]: Supply-side policy, not demand-side

Comment [A25]: Some understanding of the question. Some knowledge of relevant theory.

Level 2 8/15 marks.

SL P1 SAMPLE H

3. (a) Distinguish between structural unemployment and cyclical (demand-deficient) unemployment.

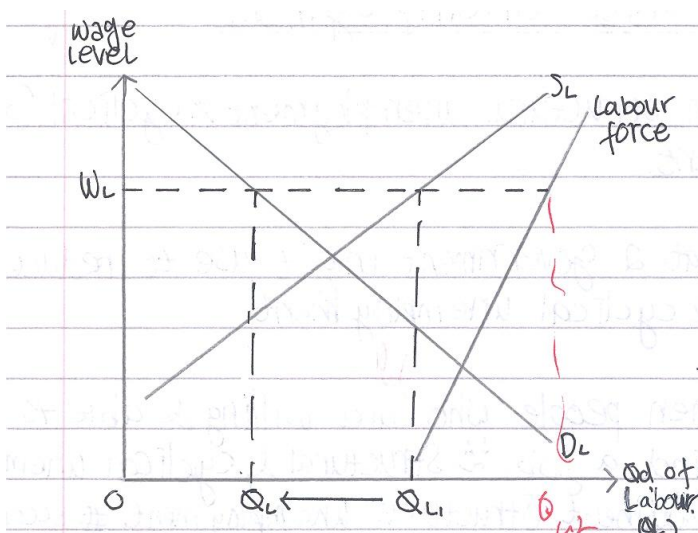
Unemployment is when people who are willing and able to work cannot find a job. Structural and cyclical are two types of unemployment. Structural unemployment occurs when a particular industry is in decline/collapse due to the loss of comparative advantage or changing trends and transition. So, for example, firms that previously produced crossword puzzle books have now shrunk due to the internet providing free crossword puzzles. Also many clothing companies in the UK are now unable to compete with the cheap cloths that are produced in China, this leads to a shrinking market share and thus jobs are cut and structural unemployment occurs.

Comment [A26]: Attempts definitions of relevant terms.

Comment [A27]: Use of an example.

On the other hand, cyclical (demand deficient) unemployment occurs in the downturn of the business cycle. During the downturn of the business cycle, the demand for goods and services falls due to reduced aggregate demand. This leads to decisions by firms to cut output because they are not able to sell as much as before. Cutting output means that not as much labour is needed and thus unemployment occurs.

Comment [A28]: Might have been a good idea to show this in a diagram.



Comment [A29]: The diagram is all right but it shows the end of a process of reasoning. Separate diagrams showing the shift in the AD_L would have been more clear.

This diagram could represent both types of unemployment, it shows that due to a decrease of demand for labour, workers that were previously employed at wage level W_L now find themselves unemployed ($Q_{L1} - Q_L$). This is caused by a downturn in the business cycle, there is less aggregate demand and these workers are cyclically unemployed. However the horizontal distance at wage W_L between SL which is the supply of workers willing to work at wage W_L and the total W_L labour force line are workers who are voluntarily unemployed and many of these are structurally unemployed. They would get work if they changed their skills.

Comment [A30]: The diagram is used and explained.

Comment [A31]: Student has produced an answer to the question that does distinguish between structural and cyclical unemployment. A diagram has been used and explained.

Level 3 8/10 marks.

- (b) Discuss policies that a government might use to reduce the levels of structural unemployment and cyclical (demand-deficient) unemployment.

The Government could use different policies to cure different types of unemployment. Different policies are needed because different types of unemployment have different causes and thus they need different solutions.

Structural unemployment occurs due to the decline of a specific industry due to its loss of relative efficiency. This could be overcome by retraining the workers so that they could adopt new skills and work in a different industry. This is a long term policy though.

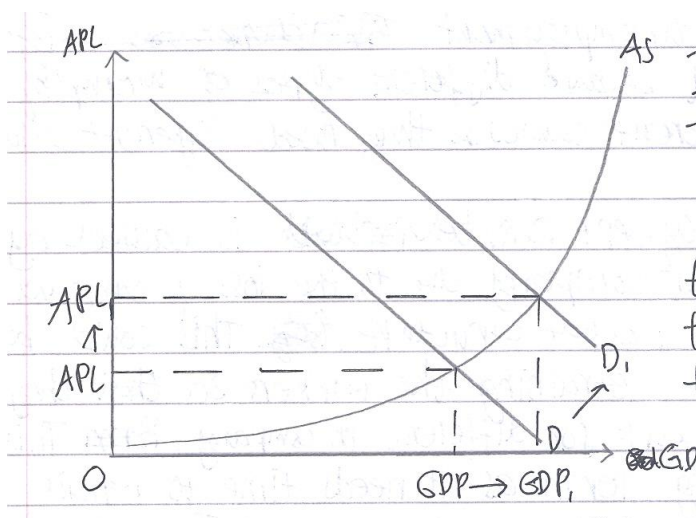
The short term solution that could be used is to subsidise the declining company. This was done in the USA during the recent financial collapse to prevent massive unemployment. Although this solution appeared to be quite effective for a short term as it gives time for the company to adapt to the market. It is also inefficient and expensive to do. It is inefficient because the company that is subsidised does not usually become more efficient and competitive because it does not have the incentive to compete (e.g. Boeing) and expensive because it requires a lot of money to be spent on the company.

Comment [A32]: Economic terms should be defined when they are introduced.

Comment [A33]: Relevant recent example.

As for cyclical unemployment, it occurs due to decreasing demand in the economy due to an economic downturn in the business cycle. This could be reduced by effectively using demand side policies to increase spending and thus raise aggregate demand and GDP. For example fiscal policy could be used to increase government spending and lower taxes. This would increase spending on goods and services in general and would reduce unemployment.

Comment [A34]: An understanding of appropriate economic information to answer the question is shown. However there is no depth to the explanation.



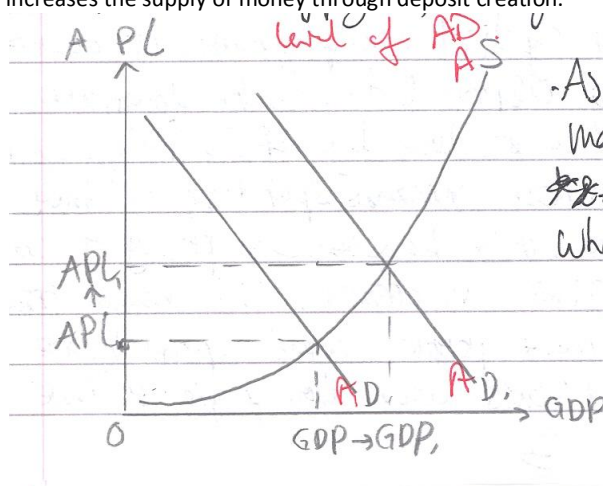
In the diagram it is shown that as fiscal policy is imposed, people would consume more on domestic goods and services as they would have more money to spend. This would lead to increased aggregate demand and thus output would be greater and firms would need more resources to produce more output and hence more workers would be employed reducing unemployment.

Comment [A35]: The diagram is referred to.

Monetary policy could also be used to reduce cyclical unemployment. For example, reducing the interest rates would stimulate the economy, this has been done in Japan, Indonesia and the UK.

Comment [A36]: Should perhaps define this although the example given is good.

Indonesia has been cutting its interest rate to near 7.5% in the hope to raise consumption. When interest rates are cut, the cost for loans is reduced and more people can afford to borrow money to invest and spend. Also lower interest rates discourage saving and so cause more spending. This increases the supply of money through deposit creation.



As spending increases AD moves to AD₁ so fiscal policy can be used to reduce cyclical unemployment. Nevertheless, the best way to reduce unemployment is to impose supply side policies. These are policies which shift the AS to the right and also reduce unemployment.

Comment [A37]: This is arrived at without having featured in prior discussion.

Comment [A38]: An awareness of policy options and some understanding of time frames related to structural unemployment. Loses sight of the distinction between the two types of unemployment toward the end of the response. Possibly time-related as the response lacks a coherent conclusion. However relevant economic theory is explained, diagrams are included and applied. Examples are given. Lacking synthesis, but evaluation attempted.

Level 3 11/15 marks.